First National City Bank
Monthly Letter
Business and Economic Conditions

New York, December, 1957

General Business Conditions

THE reduction of Federal Reserve discount rates in late November was official recognition of the weakening of both business sentiment and business performance in recent months. Since early this year new orders reaching the industries have lagged, and backlogs of unfilled orders have steadily declined. In earlier months this downward trend made comparatively little impression on business expectations. As long as production held close to peak levels, capital expenditures continued enormous, and employment and trade figures were setting new highs, there was always hope that the autumn would bring an upturn in new business sufficient to support industrial operations, in the aggregate, at the prevailing rate. These hopes have clearly been disappointed.

On the contrary, it has become evident that the economy was losing momentum. On a seasonally adjusted basis, industrial production and employment, personal income, and retail sales all dipped in September, declined further in October, and showed no signs of revival in November. Layoffs boosted insured unemployment in the first half of November more than 40 per cent above the corresponding 1956 period; to be sure, the totals are still low. The topping off of the capital goods boom was confirmed by surveys of business investment plans, and a declining rate of plant and equipment spending is indicated for 1958.

The discount rate action also reflects the easing of some conditions against which the tight money policy had originally been directed. Shortages of materials and labor have all but disappeared, and business is now striving to control rather than accumulate inventories. Business demands for bank credit have slackened in a season when ordinarily they are approaching their peak. Stock market prices reflect the shift in business expectations. Prices of basic commodities have dropped to the lowest point in 7½ years, wholesale prices generally are below their summer peak, and the extended advance in consumer prices slowed to a standstill in October. A Federal Reserve Board spokesman stated in announcing the discount rate cut that "inflation no longer is the dominant factor in the nation's economy."

Downturn in Manufacturing

So far, the adjustment has been most pronounced in manufacturing industries. On the whole, the decline this fall in other types of nonfarm employment has been no greater than could be accounted for by absences caused by the influenza epidemic. The seasonally adjusted number of factory production workers, however, has decreased month after month since the end of 1956. By October, over half a million workers had been dropped from factory payrolls since the December 1956 high, a cut of 4 per cent. Factory production declined by about the same percentage in this period.

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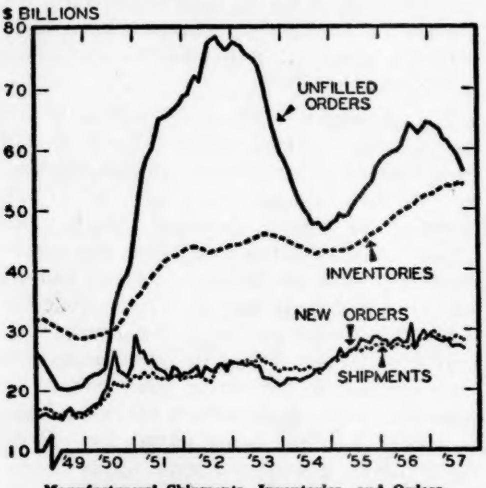
The Federal Reserve Board index of industrial production (seasonally adjusted, 1947-49 = 100) was 142 in October, down 2 points from September. Over-all output was about the same as it was two years earlier, when the sharp recovery of 1954-55 began to taper off. During the past two years, production has advanced and declined irregularly within a narrow range — a pattern characteristic of a period of rolling readjustment in which increases in some lines offset decreases in others. In the last couple of months, however, adjustments have been predominantly downward.

Shrinking Backlogs

The basic problem for manufacturers throughout 1957 has been the lack of sufficient new orders to maintain current rates of production and shipments. These developments are illustrated by the accompanying chart.



Manufacturers' Shipments, Inventories, and Orders Seasonally Adjusted (except Unfilled Orders)

During 1955 and 1956, backlogs of unfilled orders accumulated as new orders came in faster than the factories could fill them. By December 31, 1956, unfilled orders for manufactured goods had risen to $64.2 billion, the highest total since the Korean War. Through September 1957, however, new orders fell short of shipments each month this year, and manufacturers drew on their order backlogs to sustain output. In the nine months ended September 30, unfilled orders were cut more than $8 billion and the drop during September was the sharpest of all — $1.6 billion. Such a trend obviously cannot continue indefinitely. Since new business has not done as well as anticipated in the fall season, the alternative has been to cut output.

Order backlogs have been chopped most drastically in the transportation equipment industry (mainly aircraft and motor vehicles). This industry holds about one third of all unfilled orders, but accounted for over 60 per cent of the drop during the first nine months of 1957. A sizable part of this cut undoubtedly reflects the pre-Sputnik cancellations or cutbacks of outstanding defense orders and the withholding of new military orders. Other industries too felt the impact of shifts in Defense Department procurement policies, but lagging demand from business and consumers also left its mark.

More Capacity than Orders

Business men appear to have been cutting back on their orders for new machinery and equipment since late spring. Payments for orders placed and contracts signed in previous periods have kept over-all plant and equipment expenditures at a record rate all year, although postponements, stretch-outs, or cancellations of projects have cut total 1957 outlays, as estimated in October, about 6 per cent below the level anticipated last April. These same business men plan to reduce capital spending an additional 7 per cent in 1958, according to the latest McGraw-Hill survey.

The reductions in 1958 spending programs are concentrated in manufacturing, where capital outlays are expected to drop 16 per cent. Here there has been a growing gap between actual operations and capacity. Full capacity operations are obviously not the most efficient because of the need for using high-cost facilities, excessive overtime, and deferred maintenance. Industry in general has indicated in these McGraw-Hill surveys a preference for operating at about 90 per cent of capacity. In September 1957, however, manufacturing operations averaged only 82 per cent of capacity, and every major manufacturing industry was operating below the rate which it normally prefers. The high level of plant and equipment spending in 1958, despite its decline from this year's record, will produce a further rise in capacity. If, as now seems likely, factory output levels off or declines next year, the gap between capacity and operations will continue to widen. This tendency may cause further downward revision in capital spending plans as 1958 progresses.

Not all capital expenditures, of course, are primarily for expansion of capacity. Replacement and modernization of facilities always account for a large proportion of plant and equipment outlays. Particularly in a period when rising costs threaten to erode profits, management is alert to possibilities of cutting costs, saving labor, or improving efficiency through capital

expenditures. Declining sales emphasize the need for new products and improved or restyled versions of old products — and for the facilities with which to produce them. The firmness of long-range investment planning has yet to be tested in a major decline, but it undoubtedly helped sustain capital expenditures in the 1954 recession. All these factors help limit the size of next year's reduction in plant and equipment outlays. In any case, a 10 per cent — even a 20 per cent — cutback over the next couple of years would leave business investment higher than in 1955, which in its day was a new record.

Adjustment of Inventories

Business men have also been scrutinizing carefully their regular orders for goods with an eye to cutting down on unnecessary inventory accumulations. The physical volume of factory stocks of purchased materials was probably no greater at the end of September than it was at the start of this year, and over-all manufacturing inventories showed little change between May and September, although in both cases book values reflected the impact of rising replacement costs.

Inventories have been accumulating in distributors' hands, however. Between May 31 and September 30, the increase of $600 million in wholesalers' and retailers' inventories outstripped the $200 million rise in book value of factory stocks. Some of the recent rise in retail inventories may be the result of purchases based on overoptimistic expectations of fall sales, some to stocking up in hopes of a record Christmas buying season, and part to the shifting patterns of the automobile model changeover period.

In August, seasonally adjusted retail sales remained close to the July record of $17.0 billion, but inventories rose $110 million. In September, sales declined $110 million from August, while stocks advanced $200 million. Preliminary October sales data indicate a further drop of $360 million, mainly in nonautomotive lines. In the week ended November 16, department store sales lagged 5 per cent behind the corresponding week of 1956.

The decline in retail sales is not surprising in view of wages lost through layoffs and illness, loss of overtime pay, and some impairment of optimism generally. The seasonally adjusted annual rate of personal income edged down more than a billion dollars in September and October from the record $346.8 billion in August. The reduction in both months was primarily in factory payrolls. The cushioning effect of the economy's "built-in stabilizers" in the early stages of a decline was demonstrated by the fact that the decrease in October would have been about 60 per cent greater than it was except for the offsetting effect of an increase in unemployment insurance and social security benefits.

Support From the Government

In addition to the "built-in stabilizers," which in essence are either increased government payments or decreased government receipts, a turnaround in defense spending policy appears to be in the making. The vigorous efforts during the first quarter of fiscal 1958 to bring defense expenditures into line with the budget and the debt limit soon led to curtailed order backlogs and large layoffs at aircraft plants, reductions in military and civilian personnel of the Defense Department, and less liberal financing policies for defense contractors. In recent weeks, the emphasis on missile development, prompted by public reaction to the two Russian satellites, appears ready to swing defense outlays back on the upgrade sometime next year. Instead of contributing to the contraction of business in 1958, defense will help support demand.

President Eisenhower in his speech on November 13 stressed the need for increased outlays on missile development and production as well as other defense items, even if it meant an unbalanced budget. At the same time, he emphasized the desirability of compensating reductions in nonessential government programs, both military and civilian. Statements by Defense Department officials have generally followed this line, expressing the desire to hold the net increase in defense outlays to $1-2 billion through fiscal 1959. Such an increase would do little more than restore spending to the level which prevailed before the economy drive started.

The eventual size of the missile and other military programs will be clear only when Congress completes action next spring — perhaps not even then. While it takes little time to waste money, it does take time to spend it effectively. From research to testing to mass production of a new weapon is a long process which cannot necessarily be greatly speeded by money alone. However, this much is clear: The monetary authorities appear to feel that any increase in defense spending will not be big enough or come soon enough to halt the business downturn which now appears to be under way.

Construction Activity Still Expanding

More public works spending by state and local governments is looked for in 1958. The highway program is expected to expand sharply next

year, while increased outlays on schools and public housing will swell the total. Altogether, government experts estimate that federal, state, and local construction expenditures will rise about a billion dollars next year to nearly $15 billion.

Private construction activity also appears to be one of the strong points in the 1958 outlook. Recent strength in contract awards and starts indicate that home-building, which has been on the rebound since spring, will continue its moderate rise into next year. Other private construction outlays are expected to hold steady or perhaps increase somewhat next year despite the contraction in business investment, according to both government and private experts.

What the effect will be of relative strength in defense and construction demands, when set against the general recessionary trends, is hard to foresee. Perhaps the expectations of the construction experts will prove too optimistic, in an environment of general recession. Nevertheless, it is fair to assume that demand in these sectors will prove supporting influences, perhaps of considerable weight. They will provide resistance to the downward pressures together with the automatic stabilizers supporting consumer purchasing power, which were so impressively demonstrated in the 1953-54 recession. Perhaps the best aspect of the situation is that adjustment is not starting from the peak of a universally wild and reckless boom, but that piecemeal or rolling adjustments have been occurring in the economy for roughly two years — beginning with automobiles and housing after the 1955 boom, and extending through numerous other industries in 1957. In many lines the excesses have been ironed out. Where this is the case optimistic expectations even now are expressed.

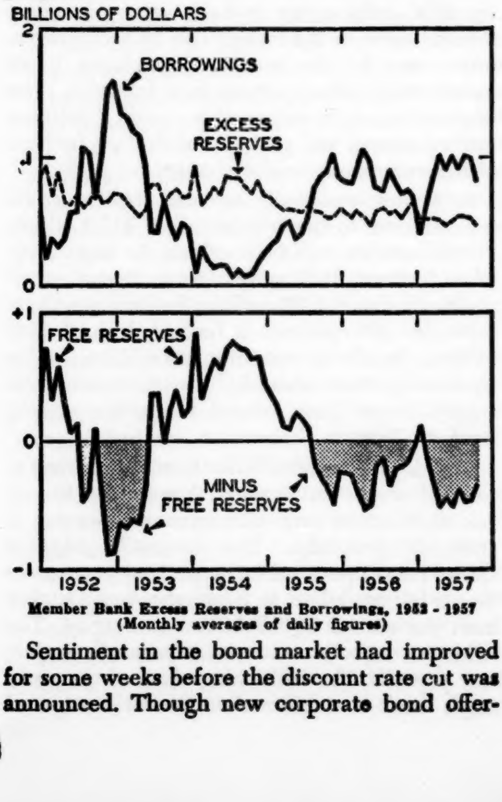
Credit Policy Reversal

After the close of business Thursday, November 14, effective the next day, discount rate cuts from 3½ to 3 per cent were announced for four Federal Reserve Banks, including New York. Seven other Reserve Banks fell in line later in the month. This action cancelled the one half per cent increases of August. It dramatically signalled a reversal of the policy of credit restraint adopted in 1955 to check excessive spending and erosion of the value of the dollar.

The rate cut, while cheapening the cost to banks of covering their deficiencies of reserves, left them as short as ever of money to lend. But the banking and financial community interpreted the move as a way of saying that substantial additional funds would be released into the market, one way or another, in the weeks to come. The action was taken to indicate that the Federal Reserve was turning around, quick and hard, not only to relieve the strain on the money and capital markets but also to give encouragement to credit expansion.

The tendency of business activity to slip off into a recession, discussed in the foregoing article, provided the justification for an easier credit policy. The predominantly discouraging tenor of business news, week after week, had encouraged expectations of a policy change. Many observers were surprised that more moderate and tentative steps, relieving pressures in the money market, were not inaugurated sooner.

The strain on the banks had already passed a peak when the discount rate cut was announced. As the chart shows, member bank borrowings from the Federal Reserve Banks had declined from an average of $1,005 million in June to $811 million in October; net borrowed reserves from $509 to $345 million. This decline did not measure relief provided by Federal Reserve operations. It reflected a policy among the banks of pressing borrowers to cover their needs for long-term money in the capital market. Moreover, beginning in October, weakening of credit demands became apparent, associated with the efforts of business men to hold down inventories and check expenditures on plant and equipment programs.



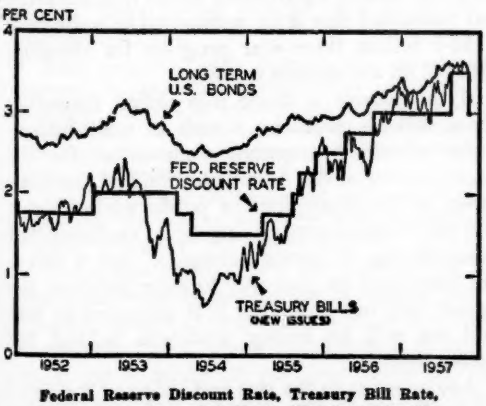
Member Bank Excess Reserves and Borrowings, 1952 - 1957
(Monthly averages of daily figures)

Sentiment in the bond market had improved for some weeks before the discount rate cut was announced. Though new corporate bond offer-

ings continued in exceptionally heavy volume, with offered yields generally running upwards from about 4¾ per cent depending on quality, the calendar of scheduled new offerings had been cut down from $2.1 billion in August to $1.1 billion on November 14. Municipal bonds had rallied, reducing yields on representative high grade issues from a peak of 3.57 per cent in August to 3.46 per cent in mid-November.

Market Effects

Firming of the bond market had been aided by momentary expectations that the Federal Reserve might soon do something to ease pressure on the banks. But a discount rate cut was more than anyone had bargained for. The markets reacted violently, attesting to the power discount rate change can have as a psychological weapon. People with money to invest promptly bought up the available supply of corporate and municipal bonds held in dealer inventories. For example, a large block of the $250 million A. T. & T. bonds, which had been slow at an offered yield of 4.90 per cent, was cleaned out in "moonlight" trading Thursday evening. U.S. bond dealers marked up their prices about a point and cut offered yields on 91-day Treasury bills from 3.40 to 3.08 per cent. Rates offered on bankers' acceptances, finance company paper, and prime commercial paper were cut one quarter per cent within a few days of the announcement of the discount rate reduction. Stock prices rallied sharply, reflecting hopes that the indicated reversal of credit policy would bolster business and make stocks more attractive investments than bonds.



Federal Reserve Discount Rate, Treasury Bill Rate, Yield on Long-Term U.S. Bonds, Weekly, 1952 - 1957

That the action was precipitate was indicated by the fact that no open market operations had been undertaken, in the usual way, to relieve the pressure on the banks and to soften open market rates to a point where a discount rate cut would naturally follow. The Treasury, which had been about to announce terms on its December financing, postponed its decision over the weekend to let the dust settle.

Before the discount rate cut it had been assumed that the Treasury would have to pay 3⅞ and 4 per cent for its money. In the excitement over the discount rate cut the Treasury got the job done easily at a money cost of 3¾ and 3⅞ per cent. The Treasury rolled over for a year $10 billion certificates of indebtedness (mostly held by the Federal Reserve Banks) at 3¾ per cent; raised $1,042 million on five-year notes paying 3¾ per cent; and realized $550 million on a sale of 3⅞ per cent seventeen-year bonds. The bond offering, the longest since 1955, reflected the desire of the Treasury to reactivate the policy of stretching out debt maturities. Having had to pay as much as 4.17 per cent to put out a special issue of Treasury bills last summer, the lesson has sunk home that floating debt finance can be a penny-wise, pound-foolish proposition as well as an embarrassment to the Federal Reserve System in the conduct of a restrictive credit policy.

More Wage-Price Spiraling?

Decisions how and when to alter the course of credit policy are the hardest the Federal Reserve authorities have to make. Possibly the greatest surprise is that the discount rate cut should have been announced the day after the President had suggested that he would be willing to see the federal budget unbalanced to cover increased expenditures. The two moves taken together seemed a double-barreled effort to prop up business, arrest the readjustment under way, and perhaps set the stage for another circle of overgenerous wage and price advances next spring. Coming at a time when the cost of living is barely restabilized, such energetic actions to loosen restraints on spending lead to the thought that the result, if not the purpose, will be to extend the process of creeping inflation. If income taxes should be increased, as ex-President Truman advocates, the upward pressure on wages and prices will be intensified.

The last fair chance to restabilize the dollar at this juncture may have been lost with the impulse, given by Sputnik, to discard the constructive policy of tax cuts within a balanced budget and to set out for new peak levels of federal expenditure. Credit policy can be retightened. But it can hardly overcome the inflationary power of a federal budget out of control.

Return to Deficit Financing?

Soviet success in sending up earth satellites, implying corresponding progress in the development of long-range rocket-powered missiles, is completely overturning the earlier plan to hold federal expenditures in fiscal '59 down around a $70 billion level and make room for long deferred tax reliefs. This plan, developed in response to taxpayer complaints over the $72 billion fiscal '58 budget, is discarded. The question now is merely how much more than $70 or 72 billion will be spent and whether the public debt limit is to be raised to accommodate renewed deficit financing.

Once the debt limit is raised, the temptation of an election year will be to enlarge spending on every front. This is all the more likely in light of the weakening trend of business. Thus, in terms of the domestic business impact, the economy seems due for the stimulation of inflationary deficit financing in place of the sounder stimulation of tax reliefs which could energize productive effort and relieve rising price pressures.

We are an impulsive people and we pay a high price for that characteristic. Some fantastic proposals are emerging for spending money in the name of national defense. Only the most spectacular is the recommendation that we should launch into a program to spend $20 billion on underground bomb shelters for the civilian population. The authors do not say what we should give up to make such a program possible, but, to be accomplished within any brief period, it would imply radical curtailment of the home-building, road, and school programs. The need is imperative to keep sense of balance and perspective.

The President's Speeches

The President has had some wise counsels to offer. In a speech on "Science and National Security" on November 7 he warned that we should not, out of a high sense of urgency, "mount our charger and try to ride off in all directions at once." The President expanded upon the budgetary implications November 13, speaking at Oklahoma City. Starting from the premise that "the first of all firsts is the essentials of our nation's security," the President warned that a "very considerable increase" in federal spending would be needed for missile development and procurement, the Strategic Air Command, improved defenses against air attack, and pay increases in the armed forces. At the same time, he deprecated demands for "indiscriminate increase in every kind of military and scientific adventure," and suggested that part of increased essential outlays should come out of savings elsewhere in the military establishment:

> **We must once more go over all other military expenditures with redoubled determination to save every possible dime. We must make sure that we have no needless duplication or obsolete programs or facilities.**

While the President, in his Oklahoma speech, appeared to rule out any cutting of mutual defense funds overseas or economic aid on grounds of their essentiality to our own defense and to keeping other nations "free of dependence upon Soviet help," it is doubtful that he intended to exclude these expenditures from the same searching scrutiny proposed for our own military outlays. Certainly no programs can be considered sacrosanct if money is being wasted. That a critical review of our foreign aid programs is called for was brought out in a General Accounting Office report to the Congress last month characterizing U.S. military aid objectives in many countries as "unrealistic" and financially unsound. This country, the report charged, had sent to some allies more weapons than they could use, and had failed to provide "adequate" accounting and reporting on the supply and delivery of military aid. The report recommended reconsideration of present programs in the light of "recipient country capabilities, United States purposes, and the priorities of desired accomplishments."

Figures Under Discussion

Although President Eisenhower did not mention specific figures, Secretary of Defense Neil H. McElroy expressed the hope November 19 that total military spending can be held within $40 billion in fiscal '59, which begins July 1. This would be a $2 billion increase over the revised estimate submitted October 1 of military outlays in current fiscal '58. On November 20, Mr. McElroy denied a published report that the army has requested that it be authorized to undertake a $6-7 billion three-year program for development of an anti-missile missile.

If the plunge is made into deficit financing, there will no doubt be a rash of multi-billion-dollar spending programs commended for the consideration of the Administration and the Congress. In the atmosphere of public excitement it will take some courage to say no to anything that bears the tag of "national defense." Yet, if this is not done, and we give way to more inflation, the money will not buy what it is supposed to buy and we will be hiding weakness behind big dollar signs.

Any guess as to the size and shape of the fiscal '59 budget is highly problematical. The Budget Bureau, under the President's direction, is working over proposals for formal submission to the Congress in January. It will then be for the Congress to decide what to add or subtract.

The Budget Problem

If the Budget Bureau and the President were to acquiesce in all the requests of the multifarious government departments and agencies for funds, total expenditures, and the deficit, would reach for the moon. One major point of resistance to holding down the budget totals will come from the military services themselves. The U.S. Chamber of Commerce gave some practical examples of this sort of difficulty in its November 15 *Washington Report*:

> Congress can often write the prescription for economy in big government but the task of getting the patient to take the medicine is a different story.
>
> Although there were no cuts in research or development funds, the recent Congress did direct economies in other areas. For example, the legislators quite properly felt that some of the needless duplication existing in the Army's seven technical services could be eliminated. Instead, the Army deactivated its famous and popular First Armored Division.
>
> For the Air Force, the Congressional thrift prescription was to curtail some of the activities of the Military Air Transport Service. Instead, this branch of the service deactivated a wing of the extremely well regarded Strategic Air Command.
>
> Meanwhile, the Navy took a good hard look at the medicine and decided, too, that this was a situation in which the illness was preferable to the cure. Rather than heed a recommendation for using civilian contract schools for primary pilot training (designed to save almost $7 million and free about 2,000 officers and men for other duties) the Navy deactivated two squadrons patrolling the vital DEW (Distant Early Warning) line.
>
> Thus, the Army, Navy and Air Force demonstrated their belief in a Washington truism — when a budget cut is inevitable impose the restrictions in those areas productive of the loudest screaming.

Nondefense Programs

In his Oklahoma City speech the President pointed to the need for putting nondefense programs "through the wringer" and to reconsider whole programs:

> Some programs, while desirable, are not absolutely essential. In this, I have reached a clear conclusion. Some say these may still be squeezed out through the wringer method. But the savings of the kind we need can come about only through cutting out or deferring entire categories of activities.
>
> This will be one of the hardest and most distasteful tasks that the coming session of Congress must face, and pressure groups will wail in anguish.

There can be no doubt but that cutting back the mushrooming nondefense programs will encounter stout resistance. This area of the budget — projected at a record $27.9 billion in current fiscal '58 — is up 24 per cent since '55, compared with a 5 per cent rise in defense spending over the same period, and seems headed ever higher.

Senator Hubert H. Humphrey has announced that he will oppose any proposal to pay for increased missile spending by cutting down on federal programs to aid farmers, labor, veterans and pensioners on the grounds that "we must maintain a strong, healthy society in this competition with the Soviet — a society in which the average family can maintain itself in dignity and comfort and freedom."

At Congressional hearings on federal spending in November, held by a Joint Economic subcommittee under the leadership of Congressman Wilbur D. Mills of Arkansas, Professors Arnold M. Soloway of Harvard and Charles E. Lindblom of Yale urged that regular federal outlays should be increased to accompany higher defense spending. Professor Soloway said: "In the world in which we live I doubt if you can separate defense and nondefense spending as clearly as you do." Professor Lindblom asserted that Americans "need to get over their traditional feeling that taxes are a plague."

All of these views tend to equate welfare state spending with national health and power. They ignore the fact that the United States was built to its present eminence and strength by the creative actions of free individuals in a free enterprise system, not by edicts of government bureaucrats. Emergency cutbacks in non-essential federal spending are not likely to sap the strength of such a country. After all, every family expects to tighten its belt when personal crisis strikes. Secretary of Commerce Sinclair Weeks' remark that "maybe the time has come when we must have a little less butter and a few more guns," has application to government administrators as well as private citizens. The taxpayer is entitled to expect a shakeout in nonessential federal spending before he is called on to approve deficit financing or tax increases.

These views also ignore the inflationary impact of increased federal spending. Giving this as his main reason for concern, Congressman Mills said that we "definitely will have inflation again next year if we add new defense spending to already existing levels of government outlays." This would be true even if the increased expenditures were offset by higher taxes, since government spends all the increased tax receipts and the taxes raise business costs and prices.

The Public Debt Limit

In 1946, after the second World War, the Congress set the public debt limit at $275 billion, a figure that still remains in force. In each of the last 3 fiscal years the Congress has given the Administration authorities to exceed the limit temporarily by $3 to $6 billion. The limit has been at times a serious inconvenience to the Treasury Department in the management of its cash posi-

tion and in getting by the first half of each fiscal year when tax revenues are smaller than in the January-June periods. On the other hand, it has been a firm barrier against the easy habit of spending beyond revenues. The needs of legislative bodies for restraints against excessive reliance upon borrowed money is recognized in many if not most of our state constitutions.

The usefulness of the public debt limit as a guard against inflationary federal spending was brought out emphatically in the hearings conducted during the past summer by the Senate Finance Committee on "The Financial Condition of the United States." Questioned on the federal debt limit, former Secretary of the Treasury George M. Humphrey said that he believed in the debt limit and that "the greatest struggle should be made" to live within it:

> It is tough and it is hard, but I think it ought to be done, and I think it is a wholesome restraint on all of us.
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> I have fought to hold to the present debt ceiling because I think that the restraint the present debt ceiling gives to the Executive, to the Congress, to everyone concerned is a very wholesome thing to have, and I think that it is like breaking through a sound barrier; there is an explosion when you go through it . . .

It has been the resistance of the Chairman of the Senate Finance Committee, Senator Harry F. Byrd of Virginia, that has kept the $275 billion limit in force these eleven years. There is a strong movement afoot to raise or discard the debt limit. The President seemed influenced by this point of view when he stated, at Oklahoma City, that the United States "will not sacrifice security to worship a balanced budget."

We have departed the rule of a balanced federal budget many times to finance wars or to cover the contingency of falling tax revenues during the depression. But we have neither war nor depression to excuse deficit financing at the present time.

The Four-Day Week

The second half of 1957 is yielding business men many disappointments. The completion of new plants often is now adding capacity in excess of current needs. As noted earlier, production schedules have not been fully justified by incoming order and consumption rates. Order backlogs thus have been tending to decline, inventories to increase. While sales are up over last year, operating costs are commonly up even more, putting the squeeze on profit margins. The continued rise in government spending has discouraged hopes that the heavy corporate tax load will be lightened next year.

To all this another — even more serious — worry has been added: labor unions' threatened demands to get more pay for less work. This is a matter of broad public concern. One of the main problems for industry today is picking up the check for overgenerous wage contract settlements in 1955 and 1956. The consumer is manifestly reluctant to pay higher prices required to finance these added costs. And if he will not pay, industrial activity must recede.

Walter Reuther, president of the United Automobile Workers, warned as early as last April he will press in contract negotiations next year for a shorter work week with increased take-home pay. Although the exact nature of the demands will not be decided until January, Mr. Reuther has talked in the past about a four-day, 32-hour week.

David McDonald, president of the United Steelworkers, mentioned not long ago the possibility of a three-to-four month paid vacation every five years for each union member. The International Association of Machinists has called for eventual establishment of a 30-hour week with no reduction in pay. The International Typographical Union adopted a resolution in August permitting its locals to negotiate contracts for a four-day week. Al F. Hartung, president of the International Woodworkers of America, urged the AFL-CIO on September 10 to "take the lead" in bringing about a shorter work week "by whatever method is necessary."

Apparently the Russian Sputniks have not affected labor leaders' determination to push for more leisure. The Transport Workers Union announced October 21 a "basic goal" of a 30-hour week with "higher take-home pay and other benefits." And O. A. Knight, president of the Oil, Chemical & Atomic Workers Union, insisted November 8: "We should begin preparing now for a shorter work week to be applied when needed instead of waiting until there are several million unemployed."

Management's concern over labor leaders' avowed aims is apparent in recent public statements. For example, Ernest Swigert, president of Hyster Company and of the National Association of Manufacturers, warned in October that a shorter work week will give the unions "a device to secure more overtime" and will "speed up the destructive course of inflation." Thomas Patton, president of Republic Steel Corporation, stated on September 24 that it would take "an awfully long strike and intervention of the Government" to shorten the steel industry's work week without lowering weekly pay.

Thus a work-week issue has moved into national prominence. How much we work and how much time we devote to leisure will directly af-

fect our material welfare in peace and our defensive potential in war. It is worth-while to take a close look at the implications of a shorter work week.

An Appealing Idea

The general idea of fewer working hours, without a cut in paycheck, is certainly attractive. A shorter workday could mean more time for family life, more opportunity to take part in social and civic affairs, as well as more hours to relax and loaf. A regular three-day week end might be a boon to people who like to take short trips, putter around the garden, or tackle major projects about the house.

Of course there is always another side to the coin: who is going to foot the bill? Wages must be paid out of production. If people work less and produce less, there will be less to be consumed. If workers in a given industry cut out a day's work without a cut in weekly wages, the costs of production and the price of their product will be raised. If everybody does the same thing, and all prices rise, the same wage can no longer support the same living standard.

The historical trend in this country has run towards more pleasant working conditions, more machinery to save labor, and shorter working hours. Although early statistics are sketchy, there is evidence that the average factory worker about a hundred years ago put in an 11 or 12-hour day six days a week. Last year the average production worker in manufacturing labored only eight hours a day for a five-day week (and got more pay for not working — *i. e.*, vacations, holidays, and coffee breaks — than ever before). Workers' living standards, meanwhile, have advanced to record highs.

The decline in working hours has varied, of course, with the type of job. This was pointed up by Leo Wolman in a study in 1938 for the National Bureau of Economic Research. He noted that while the most common working week in manufacturing was down to 60 hours by 1890, bakers worked more than 65 hours a week while the newspaper and magazine printing industry were on a 52-hour schedule.

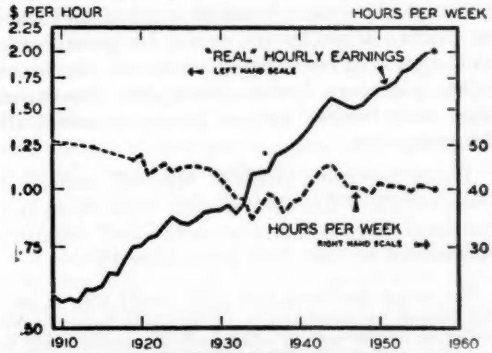
Historically, the trend towards shorter working time has followed a pattern of cuts in daily hours and then reductions in the number of days worked.

Dr. Wolman demonstrated this by tracing developments in the bituminous coal industry between 1903 and 1937. He noted that in 1903 a little less than half of the miners were working 9 and 10 hours a day six days a week; the rest worked 8 hours daily. By 1920 only 3 per cent of the miners were working more than 8 hours a day. In 1933 the work week was reduced to five days and in 1934 the miners' work day was cut to 7 hours — roughly the same work schedule as in effect today.

A number of significant milestones have been passed since the turn of the century. Broadly speaking, the 8-hour day began to gain wide acceptance during World War I. The six-day week began to yield to the 5½ day stint during the 1920's. The depression of the 1930's promoted work-sharing schemes and many NRA industry codes featured 40-hour weeks. That movement culminated in the Fair Labor Standards Act of 1938, which placed all industry engaged in interstate commerce on a statutory 44-hour week and called for a gradual reduction to 40 hours by 1940. The war years brought about a lengthening of work schedules despite the premium rates required for overtime. But by 1946 the five-day, 40-hour week was again pretty much the rule.

The Rate of Progress

This progress has come about because labor has been made more productive through progressive development of better and more efficient tools and machinery. As will be seen in the chart, based on U.S. Bureau of Labor Statistics data for the manufacturing industry, workers have taken some of the benefits of greater output in more leisure, but more in higher wages. That is why living standards have risen so high.



Hours of Work and "Real" Hourly Earnings (in 1956 prices) of Production Workers in Manufacturing. (Source: U.S. Bureau of Labor Statistics; 1957 figures are averages for first 10 months.)

Unless government picks up in taxes all the fruits of progress, automation and other technological advances in the years ahead are expected to make possible similar increased benefits. The staff of the Congressional Joint Economic Committee, for instance, suggested in 1954 that a reduction of about four hours in the work week for nonfarm industries might be possible between 1953 and 1965 along with rising wage rates and living standards.

Since 1941, the first full year after the 40-hour week was legally established, there has been no appreciable shortening of the standard work week. Real wages have continued to rise, at an average rate of 2.7 per cent per year compounded. In the postwar period, obviously, workers have preferred to take cash (and other benefits) rather than a shorter work week. It has been helpful to the federal tax revenues – and to the resources available for defense – that this has been so.

Mr. Reuther is on record that his union will insist on rising living standards and greater leisure simultaneously. Such gains would have to come out of increased productivity, which over the long run has averaged between 2 and 3 per cent a year. If this rate of improvement can be sustained, and if workers should divide their benefits between hours and wages as they did in 1909-41, it would take some 31 years to lower the work week one fifth to 32 hours, but living standards would rise steadily to new records If real earnings and living standards were left at the present level, it might be possible to accomplish the shift to a 32-hour week in less than 8 years. Spaced out evenly, this is to say that working time could be cut about two seconds each passing hour on the job.

Should, however, a sharply shortened work week be suddenly forced on the economy through the monopoly power of labor, the effect would be economic disruption, lower production, and higher prices. More leisure would be gained only at the price of lower living standards. American labor had more leisure during the depression than ever before. Leisure is a poor substitute for prosperity.

Labor Secretary James P. Mitchell warned of the dangers of forcing a shorter work week at a luncheon before the Commerce and Industry Association of New York September 18:

> We cannot consider it [a four-day week] without paying heed to its consequences. I don't think any arbitrary reduction of the existing work week is a sound thing to consider at this time. We have to let this thing come by evolution and not to the detriment of the full use and development of our resources.

Certainly we cannot keep up with the Russians in science and industry if we make leisurely relaxation our chief aim in life.

Share-the-Work Psychology

The main argument put forth by labor leaders in support of shorter hours was summarized by the AFL-CIO in its October 1956 *Collective Bargaining Report:*

> Although sentiment for further hours reduction is rooted in part in a general desire for more leisure time, it is more widely based on the ground that shorter hours of work will help maintain employment opportunities . . .
> . . . For some industries, technological change and expanding productivity may present employment difficulties if there are inadequate markets for increased output . . .

Passing over, for the moment, whether the AFL-CIO is correct when it claims there is a "general desire" for more leisure, its concern over future employment opportunities seems to ignore the fact that many observers expect that a shortage of labor – not a surplus – will be the big problem in the years ahead.

This was pointed up by William G. Caples, vice president of Inland Steel Company, and Paul L. Davies, chairman of Food Machinery & Chemical Corporation, in the November 1956 issue of *Factory Management and Maintenance* Said Mr. Caples:

> All of the population growth figures we have studied indicate that given a constant rate of increase in national product and the resultant rise in the standard of living, that we will still be short 2 million people in 1975 even if the work week continues as it is.
>
> It seems to me that the real fear should be whether our technology can keep pace with the demands on it – not whether the work week will be shorter.

Noted Mr. Davies:

> . . . Most economists predict a large increase in consumer demand and our gross national product over the next 10 years, with possible limitations being only the supply of skilled labor and the capital to take care of our expanded facilities. I do not believe a reduction in the work week would be possible without limiting our opportunities for the continued growth in our economy . . .

Donald G. Mitchell, chairman and president of Sylvania Electric Products, was quoted in the April 5 *New York World Telegram & Sun* as predicting for 1975: "Even if automation is continued at its present rate, every available worker – more than 80 million – will have to be putting in 40 hours a week in order to keep raising our standard of living at the rate it is being increased today."

Who Wants Shorter Hours?

Do workers want a shorter work week? The idea got a chilly reception from the public last July in a survey by the American Institute of Public Opinion (Gallup Poll). By a 2-to-1 vote, workers said they would not like to see a four-day week adopted. The majority of the men opposed the idea while women turned thumbs down on the proposal by a 3-to-1 margin.

Additional evidence of workers' dislike for a shorter work week comes from labor's own

ranks. For instance, the Mechanics Educational Society of America, an AFL-CIO union, complained bitterly in August 1956 that after fighting to cut the workday many unions are seeking to work longer hours to get premium pay:

> For the most part, labor has scrapped the eight-hour day. The fight for nice juicy overtime has taken the place of the fight for the shorter work day. Almost without exception, labor has advanced backward.

George Brooks, research director of the Pulp, Sulphite and Paper Mill Workers, told an AFL-CIO Conference on Shorter Hours held in September 1956 that aside from workers' desire for paid holidays and paid vacations there is "no evidence in recent experience that workers want shorter daily or weekly hours." "Workers are eager to increase their income, not to work fewer hours," he added.

The Akron rubber workers provide a case in point — as was noted by Joseph Bertotti, manager of General Electric's Research Department, in a speech before the American Management Association in February:

> Researchers of the Rubber Workers Union reported that when workers are employed on six-hour shifts, as about 30,000 are in the rubber industry, a substantial part of them have two jobs. For instance, about 10 per cent of the rubber workers in Akron have a second full-time job, and 30 to 40 per cent have part-time jobs.
>
> Incidentally, one consequence of this situation is an over-all reduction in the number of people who can find employment in the area, since so many rubber workers have two jobs. A second consequence has been a reported dropping off in efficiency of the workers who hold two jobs and who come to work far less rested than do those working the standard 8-hour day.

Really After Premium Pay?

Behind the talk of shorter hours there seems to be an assumption that workers' material needs and wants are already satisfied. This overlooks the fact that the American worker has consistently sought to improve his living standard.

Willford I. King, a noted economist, has estimated that today's worker could, by working only 16 hours per week, produce as much, earn as much, and live as well as did his prototype of a century ago. Explaining why workers put in 40 hours a week, Dr. King notes:

> Today's factory worker knows that, if he put in only 16 hours a week, he could not earn enough to pay for a choice collection of foods at all seasons, central heating in his home, fashionable clothes for his wife, an electric refrigerator, a television set, frequent attendance at the movies, an up-to-date automobile, and a fine vacation trip every summer.

The average factory worker's hourly earnings last year were more than three times his 1939 wages, and even after adjusting for the rise in consumer prices his real hourly wages were nearly 60 per cent higher than in 1939. Nevertheless, he still worked five days a week because jobs were abundant and he wanted the increased income. Even at today's record pay, many people put in extra work on the week ends to boost their purchasing power. A Census Bureau survey in July 1956 found that 3.7 million workers held two jobs — double the number of multiple job holders reported in July 1950.

This all suggests that what labor leaders may really be after is not more leisure for workers but having all work beyond four days a week paid for at premium rates. That is to say, to gain big wage increases in the name of a reduced normal work week.

The impact on industry could be staggering. For instance, to pay factory production workers the same weekly pay for four days' work as they now get for five would boost average hourly wage costs 25 per cent. If a fifth day at time-and-a-half were scheduled to maintain production, industry's wage bill for production workers would jump 37½ per cent. Should such a wage boost spread throughout the economy, the nation's 1956 total of $227 billion in wages and salaries would jump $85 billion. Industry does not have this kind of money to finance payroll increases but if it did the resultant inflation would put to shame the inflationary creep which we have been experiencing.

Unhatched Chickens

The labor leaders are counting a lot of unhatched chickens. Before workers can be paid more for working less they will have to become more efficient and productive. This will take improved tools and machines made possible by inventive genius, a steady flow of savings, and adequate profits so business can build with internal funds and attract outside capital. It will also take time — a fact some union chiefs overlook or ignore.

A shorter work week with the same or higher pay cannot be simply decreed by labor or legislated by governments. It will only be possible when the country, because of improved technology and productivity, can afford it.

And, as we are reminded by Cola G. Parker, chairman of the National Association of Manufacturers, regardless of the progress of technology, automation, and other scientific advances, it always will be true that the more hours or days we work in the aggregate, the more we will have.

This country did not get where it is today because of a national preoccupation with leisure. Work is still the only way to abundance.

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